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C O N F I D E N T I A L SECTION 01 OF 04 TOKYO 002283

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SUBJECT: METI'S ASIAN FTA PROPOSAL: TACTICS WITHOUT STRATEGY

REF: A. TOKYO 2130

1B. TOKYO 2240

Classified By: Joe Donovan, Charge d'Affaires, a.i.

Reason: 1.4 (b,d)

11. (C) Summary: METI Minister Nikai's recent regional FTA proposal is a tactical move to counter an expected Chinese-backed regional FTA proposal to be presented to an August ASEAN Plus Three Economic Ministers' meeting. METI however, seems not to have considered the longer-term implications of this proposal on APEC or on the U.S. presence in the region and largely ignored other GOJ agencies in formulating its proposal. Nevertheless, because it has the strong backing of Minister Nikai, this proposal could gain momentum. End summary.

METI Officials Stress Fears of Chinese Dominance

12. (C) In his meeting with the DCM on April 18 (ref A) Economy, Trade and Industry Vice Minister Kazumasa Kusaka explained that Minister Toshihiro Nikai's proposed "Comprehensive Economic Partnership in East Asia" (CEPEA) centered on countering ideas for increased regional integration limited to members of ASEAN Plus Three. China's growing economic strength was exerting a kind of centripetal force drawing in the other regional economies, including Japan, Kusaka said. Japan was seeking to counterbalance this force. Kusaka acknowledged that Nikai's proposal was not interagency-agreed Japanese Government policy but added that the Minister's initiative, in being made public, had already advanced an alternative to an FTA among ASEAN Plus Three members alone. If accepted by the other ASEAN Plus Three Trade Ministers, Nikai's proposal would "broaden the base of the mountain" and "make the summit higher," thus necessitating a longer climb through a series of "base camps" -- i.e., bilateral FTAs -- along the way, according to Kusaka. As a result, Japan would seek to finalize the

bilateral agreements it currently has under negotiation before being drawn into a multilateral exercise tied to ASEAN Plus Three.

¶3. (SBU) Meeting with EMIN on April 20, METI Trade Policy Director General Toshiaki Kitamura further stressed that Japan wants the United States to stay engaged in the Asia-Pacific region. He explained that the genesis of METI's idea for an East Asian FTA was in response to Chinese moves in the region. METI's proposal was driven by the need to table another proposal before the August ASEAN Plus Three Economic Ministers meeting which would discuss a study group report advocating an ASEAN Plus Three FTA. METI saw the study group proposal as unacceptably limited both in terms of membership and coverage and as strongly influenced by the Chinese. Japan would not be able to accept this proposal and therefore risked being left out of a possible China-Korea-ASEAN regional FTA attempt. Kitamura also claimed that Japanese business strongly supported METI's approach. Kitamura said Japanese businesses were not interested in an FTA with China but did seek stronger rules-based behavior by the Chinese.

¶4. (SBU) With respect to the Asian Pacific Economic Cooperation forum (APEC), Kitamura felt that 2006, with Vietnam as host, would not be a good time to revitalize APEC. He suggested that the United States, Australia, and Japan work together in preparation for Australia's turn to host in 2007 and devise a more systematic vision to guide APEC from 2007 to 2010, when Japan will host APEC.

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¶5. (C) Econoffs received a much less nuanced presentation of METI's thinking from Tetsuya Watanabe, the official in the Trade Policy Bureau tasked with drafting the METI "Global Economic Strategy" report on which the Minister's regional FTA proposal had been based. METI did not propose using APEC as the channel for its regional FTA concept to avoid "frightening away" the ASEAN countries with the prospect of having the United States at the negotiating table, Watanabe said. The Japanese proposal, he acknowledged, would also initially aim at a fairly low level of liberalization; it would be broad but not deep. METI's vision of East Asia's regional architecture was one of a set of different fora -- i.e., APEC, EAS, ASEAN Plus Three -- with overlapping membership. On the other hand, China, Watanabe said, sought a more centralized EU-like architecture that it would dominate. Watanabe stressed that the main substantive difference between what METI had proposed and what was likely to emerge from the ASEAN Plus Three study group was not the difference in scope or participation but rather that the former would be a Japanese initiative and the latter Chinese.

Foreign Ministry Discounts METI Proposal

¶6. (C) In a meeting with the Charge on April 24 (ref B), Deputy Foreign Minister for Economic Affairs Mitoji Yabunaka confirmed that Minister Nikai's proposal had not been coordinated with other ministries and that it was simply a "grand concept" yet to be organized and vetted within the Japanese government. He noted, nevertheless, that there might be a case over the longer term to seek a regional FTA rather than a network of bilateral FTAs. He went on to say that, even though APEC confirms the U.S. interest in East Asia and Japan appreciates the forum's inclusive nature, the United States and Japan

needed to re-energize its activities.

Academic Stresses Japanese Isolation in Region

¶17. (SBU) Waseda University Professor Shujiro Urata, one of the Japanese academic participants in the ASEAN Plus Three study group on a regional FTA, told econoff on April 21 that participants in that exercise had only begun to exchange reference documents for the study at a meeting held in Tokyo the previous week. Urata noted that he is the only Japanese academic participating in the study who is not a former METI official and acknowledged that it had been rather awkward for his (former METI) colleagues at the latest meeting who felt obliged to advocate the METI position on additional membership in the proposed regional FTA.

¶18. (SBU) In Urata's view, Japan's chief concern over Chinese dominance of the ASEAN Plus Three economic integration exercise stemmed from the tendency of major Chinese firms to base production and investment decisions on political rather than economic factors. This behavior, if extended throughout the region, would distort markets in East Asia. (Comment: Professor Urata's concern over the influence of politically motivated Chinese corporate behavior in the region seems excessive and more an effort to rationalize Japanese fears than to postulate a probable outcome. End comment.) Japan, Urata stressed, was the only large developed economy in the ASEAN Plus Three group and was, consequently, isolated. Developing countries dominated ASEAN, and they tended to focus on the near-term benefits of

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immediate liberalization in trade in goods with China rather than worry about long-term systemic distortions in the regional economy. In addition, ASEAN's developing members themselves lacked solid market-based economic systems and were not as interested in establishing a comprehensive, rules-based regional economic regime as Japan.

¶19. (SBU) Urata saw the Chinese as pursuing a gradualist strategy on economic integration, starting with liberalization on trade in goods and expanding step-by-step into other areas such as investment and intellectual property protection. Urata acknowledged that this was the usual Chinese approach to reform and agreed that it made sense in the context of a developing country. Japan, he noted, as a developed economy could not accept such an approach, however. There were too many important economic constituencies in Japan that would insist on more progress regarding investment and IPR for Japan to be satisfied with anything less than a much more comprehensive agreement than what the Chinese were advocating.

¶110. (SBU) Urata believed that Japan would have no choice but to accept the report coming out of the ASEAN Plus Three study group in August but added that Japan should continue to advocate for expanding membership in the proposed regional FTA. Keeping the door open for additional members like Australia and India was about all Japan could hope to accomplish in the near term, Urata said. Nevertheless, he doubted the ASEAN Plus Three could negotiate any FTA agreement quickly. He noted that some had said a regional agreement could be based on the separate agreements that China, South Korea, and Japan are all negotiating or have negotiated with ASEAN, with latter two expected to be completed by the end of 2007. This concept was unlikely to work out, however, because all three agreements have substantially different content

in such areas as rules of origin. It would most likely be necessary to negotiate an ASEAN Plus Three agreement from scratch.

Australians Also See Strategic Vacuity at METI

¶11. (SBU) Our Australian Embassy counterparts share our assessment that METI's proposal is primarily tactical in nature in that it attempts to seize the initiative from China, but lacks a longer-term strategic vision for the region. Australian Embassy Deputy Chief of Mission Penny Richards told EMIN April 20 that her soundings of various Foreign Ministry, Agriculture Ministry, and METI officials had indicated strong opposition to METI's proposal. METI Trade Policy Deputy Director General Akira Miwa (who is a former Japanese APEC Senior Official) had emphasized to Richards concerns over the report of the ASEAN Plus Three study group but had also failed to show any appreciation of the broader implications for APEC and other regional initiatives if the METI proposal were realized.

Comment: Deck Chairs on the Titanic?

¶12. (C) METI has been somewhat taken aback by the strong negative interagency reaction to Minister Nikai's proposal and to U.S. expression of concern. In all of the above-mentioned meetings we have conveyed the strong view that the United States is an Asia-Pacific nation and we want to remain engaged in the region's economic architecture. METI recognizes it committed a blunder by not utilizing a stream of

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high level visits (Vice Minister Kusaka's trip to Washington DC, Deputy USTR Bhatia's visit to Tokyo) to brief us on its thinking in advance of the Minister's announcement.

¶13. (C) Underpinning Minister Nikai's initiative is a visceral fear of ASEAN drifting too far into China's orbit. Nikai's proposal, missed an opportunity to redirect regional integration energies toward more inclusive approaches that might include the United States into the regional economic architecture or revitalize APEC. Neither does METI offer an answer for how Japan plans to handle the Taiwan problem in its Asian trade integration proposal. The most benign assessment of METI's proposal could be that it attempts to delay changes to the status quo in East Asia by complicating the process of regional integration. The Japanese probably would be content to see an ASEAN Plus Three trade liberalization process stall -- thereby avoiding having to choose between protecting domestic constituencies or regional isolation. Other Asian countries, however, may not allow Japanese inertia to hinder continued, albeit limited regional trade liberalization. Moreover, Nikai remains an influential figure in the ruling party and, with Japan facing a leadership change in September, his thinking could win over Prime Minister Koizumi's successor.

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